

Message Text

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TAGS: PFOR, AMGT, ECON, ID
SUBJECT: EAST ASIA ECONOMIC POLICY REVIEW

REF: STATE 73295

1. WE HAVE REVIEWED ECON POLICY AREAS DESCRIBED REFTTEL AND OFFER FOLLOWING ANALYSIS AND OBSERVATIONS CONCERNING THOSE AREAS AS THEY RELATE TO INDONESIA. THESE COMMENTS SHOULD BE REGARDED AS SUPPLEMENTARY TO OUR PARM SUBMISSION AND OTHER, FULLER EMBASSY REPORTING ON THESE ECONOMIC ISSUES.

2. COMMODITIES: INDONESIA'S DEPENDENCE FOR FOREIGN EXCHANGE EARNINGS ON COMMODITY EXPORTS IS SIGNIFICANT AT THIS TIME AND WILL BECOME CRITICALLY IMPORTANT AS EXPORTS OF CRUDE PETROLEUM BEGIN TO DECLINE IN THE NEXT HALF DECADE. THUS IN ITS OWN INTEREST, BUT ALSO BECAUSE THE GOI IS GENUINELY COMMITTED TO THE ACHIEVEMENT OF GREATER PROSPERITY FOR ITS THIRD WORLD PARTNERS, IMPLEMENTATION OF UNCTAD'S INTEGRATED PROGRAM FOR COMMODITIES AND COMMON FUND IS AMONG INDONESIA'S PRINCIPAL ECONOMIC POLICY GOALS. WE FULLY EXPECT
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THE GOI TO REMAIN IN THE FOREFRONT OF LDC'S SEEKING TO CONVINCE THE DC'S, AND PARTICULARLY THE US, OF THE URGENT NEED TO IMPLEMENT THESE PROGRAMS. WITHIN THE CONXTX OF THE NORTH-SOUTH DIALOGUE NO ACTION WOULD BE VIEWED MORE FAVORABLY BY INDONESIA THAN US SUPPORT FOR THE KIND OF COMMON FUND ACCEPTABLE TO THE LDC'S.

3. TRADE: GOI OFFICIALS HAVE SPOKEN AT LENGTH RECENTLY OF THE NEED

FOR PROMOTION OF NEW EXPORT INDUSTRIES AND FOR IMPROVEMENTS IN THE FLOW OF TRADITIONAL EXPORTS AND ON THE DESIRABILITY OF USING SUCH MECHANISMS AS THE GSP AND THE MTN TO INDONESIA'S BEST ADVANTAGE IN GAINING ACCESS TO DEVELOPED MARKETS. IN REALITY, INDONESIA'S EXPORTS FOR THE FORESEEABLE FUTURE WILL CONTINUE TO BE DOMINATED BY CRUDE PETROLEUM, AND A SMALL NUMBER OF OTHER RAW MATERIALS AND COMMODITIES, INCLUDING TIMBER, RUBBER, NON-PROCESSED FOOD ITEMS, NICKEL AND TIN. LNG AND NICKEL WILL BE THE ONLY SIGNIFICANT NEW EXPORT

EARNERS IN THE NEXT SEVERAL YEARS. FAVORABLE US ACTIONS IN THE MTN (KEEPING WHAT THE GOI BELIEVES WAS A PLEDGE TO STRUCTURE THE RULES

IN A MANNER ADVANTAGEOUS TO LDC'S; DROPPING US DEMANDS FOR LDC RECIPROCITY) AND WITH REGARD TO THE GSP (EXCLUSION OF INDONESIA FROM THE GROUP OF NATIONS BLACKLISTED FOR AN ACTION IN WHICH INDONESIA DID NOT PARTICIPATE) WOULD NEVERTHELESS HAVE SYMBOLIC IMPORTANCE FAR BEYOND THE RELATIVELY MINOR ECONOMIC CONSEQUENCES.

4. WITH REGARD TO INDONESIA'S IMPORTS, WE NOTE WITH DISMAY THE APPARENT TREND TOWARDS ADDING FURTHER PROTECTIONIST BARRIERS TO AN ALREADY HIGH TARIFF STRUCTURE. EVEN THOUGH THESE BARRIERS HAVE NOT BEEN ESPECIALLY HARMFUL TO US EXPORTS TO INDONESIA DUE TO THE NATURE OF THE ITEMS WE SELL HERE, WE THINK THE US SHOULD NOT HESITATE TO IMPRESS UPON THE GOI THE UNFAVORABLE DOMESTIC CONSEQUENCES, AS WELL AS THE DAMPENING EFFECT ON WORLD TRADE, OF OVER-PROTECTIONISM. A SECOND TREND IN INDONESIAN IMPORTS, PARTICULARLY THOSE OF THE

GOVERNMENT, INVOLVES THE GROWING INSISTENCE ON OFFICIAL SUPPLIER LIMITED OFFICIAL USE

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CREDITS. THE US WILL BE UNABLE TO SURPASS, OR EVEN TO MATCH, THE RECORD LEVEL OF EXPORTS TO INDONESA ACHIEVED IN 1976 (IN EXCESS OF \$1 BILLION) UNLESS US BUSINESSMEN HAVE THE FULL SUPPORT OF THE EXPORT IMPORT BANK. SUCH SUPPORT IS ESSENTIAL IF SALES ARE NOT TO BE LOST TO COMPETITORS FROM COUNTRIES IN WHICH THE EXIM AUTHORITIES HAVE PROVEN MORE FLEXIBLE WITH REGARD TO CREDITS TO INDONESIA.

5. PRIVATE CAPITAL FLOWS: FOREIGN INVESTMENT IN INDONESIA HAS DECLINED SHARPLY IN RECENT YEARS. SUCH NON-EXECUTIVE BRANCH USG ACTIONS AS SECTION 911 AND SEC PROBES WHICH RESULT IN GREATER CAUTION ON THE PART OF POTENTIAL INVESTORS MAY HAVE CONTRIBUTED TO THE DWINDLING US BUSINESS INTEREST IN INDONESIA, BUT THE DECLINE IS LARGELY ATTRIBUTABLE TO DOMESTIC FACTORS AND RESTORATION OF A FAVORABLE INVESTMENT CLIMATE WILL DEPEND PRIMARILY ON THE GOI. (A NOTEWORTHY EXCEPTION WOULD BE AN OPIC DECISION TO INSURE OIL AND GAS INVESTMENTS HERE.) WITH ACCESS TO FOREIGN EQUITY CAPITAL LARGELY DENIED, INDONESIA'S CONTINUED ABILITY TO TAP FOREIGN CAPITAL MARKETS IS ESSENTIAL. WHILE THERE IS NO CURRENT NEED FOR INDONESIA TO GO TO THE MARKET, PRUDENT DEBT MANAGEMENT MAY DICTATE THE

REFINANCING OF AT LEAST A PORTION OF THE LARGE SYNDICATE LOANS UNDERTAKEN AS A RESULT OF THE PERTAMINA CRISIS, IN ORDER TO DISTRIBUTE MORE EVENLY THE DEBT SERVICE REQUIREMENTS OF THESE LOANS. WE ARE CONCERNED THAT IN THIS CASE, OR IN THE EVENT OF OTHER FUTURE NEED FOR ADDITIONAL COMMERCIAL CREDIT, INDONESIA'S ABILITY TO TAP THE MARKET MAY BE IMPAIRED BY THE RECENT "SPECIAL MENTION" CLASSIFICATION OF INDONESIA BY US BANK EXAMINERS. HAD SUCH AN ACTION BEEN TAKEN 18 MONTHS AGO, AT THE HEIGHT OF THE PERTAMINA CRISIS, WE WOULD NOT HAVE PROTESTED. BUT FOLLOWING THE GOI'S SINGULAR SUCCESS IN IMPROVING THE AILING FINANCIAL SITUATION, IT STRIKES US AS A CURIOUS REWARD FOR A JOB WELL DONE. WE HOPE AND TRUST THAT THIS CLASSIFICATION WILL PROVE TO BE OF SHORT DURATION.

6. INTERNATIONAL FINANCIAL INSTITUTIONS: CONTINUED ASSISTANCE FROM THE IFI'S, WITH WHICH INDONESIA HAS GENERALLY EXCELLENT RELATIONS, WILL BE NECESSARY FOR THE FORESEEABLE FUTURE. WE URGE THAT THE IFI'S LIMITED OFFICIAL USE

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USE THEIR POTENTIAL LEVERAGE TO PROD THE GOI INTO FACING UP TO THE DIFFICULT BUT INESCAPABLE PROBLEMS OF CORRUPTION, THE NEED TO INCREASE DOMESTIC REVENUES, AND WRMING UP THE INVESTMENT CLIMATE.

7. OFFICIAL BILATERAL CAPITAL FLOWS: AFTER LONG AND STRENUOUS PROTESTS, THE GOI HAS NOW ACCEPTED THAT THE PL-480 TERMS WE GRANT IT WILL NOT BE EASED. THIS ACCEPTANCE WAS NO DOUBT FACILITATED BY THE CURRENT VERY HIGH LEVEL OF COMMODITIES WE PROVIDE INDONESIA UNDER THIS PROGRAM. INDONESIA'S FOOD IMPORT REQUIREMENTS UNFORTUNATELY WILL NOT DECLINE SOON, AND THE GOI WILL CONTINUE TO LOOK TO THE US FOR SUPPORT. WITHIN THE CONSTRAINTS OF COMMODITY AVAILABILITIES WE SHOULD CONTINUE TO MEET THEIR REQUEST WITH A SYMPATHETIC RESPONSE. NEWSOM

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